Nagashima Ohno & Tsunematsu

Impact of the New Company Law

By Yu Wakae

NAGASHIMA OHNO & TSUNEMATSU

The new *Company Law* of Japan came into effect on May 1 2006. It substantially altered the Commercial Code and provides Japanese companies with far greater flexibility, such as increased choice in relation to dividend payments and securities design.

(i) Dividend payments

Under the Commercial Code, dividend payments were limited to one year-end dividend and one interim dividend per year. Under the *Company Law*, any number of dividend payments during a business year may be made so long as the prescribed requirements are met. Dividend payments – including end-of-year dividends – may also be authorized simply by a board resolution, if so provided in a company's articles of incorporation. Many companies are making this change to their articles in order to allow for this new regulation.

(ii) Securities design

The *Company Law* provides for a more flexible design of securities issued by companies. For example, companies can issue convertible bonds (CBs) with mandatory conversion provisions or stock acquisition rights with mandatory exercise provisions by including acquisition clauses. The latter might be utilized as a "poison pill" takeover defense.

The TSE: Contemplating tighter restrictions

The Tokyo Stock Exchange (TSE) is considering whether it should impose tighter restrictions on its listed companies to give investors greater protection. The TSE asked the public for its opinion in March 2006, and is expected to publish its action plan in June. Items that were discussed include the stock splits and the issurance of equity securities.

Stock splits

Some Japanese companies have intentionally introduced stock splits to boost share prices. As a result, the TSE has asked listed companies to voluntarily refrain from making stock splits of 1:5 or more or that would make the trading unit of the share below ¥10,000 (US$86). The TSE is considering making similiar limits binding by including them in its listing rules.

Issuance of equity securities

Under the *Company Law*, companies may issue new shares, stock acquisition rights or CBs by resolution of the board of directors, unless they are issued on specially favourable terms. To ensure that such issuances are not detrimental to existing shareholders, the board usually obtains a valuation letter from a finance specialist and a legal opinion from its counsel before passing the resolution. Shareholders may apply for an injunction by the closing date. However, market critics argue that moving-strike convertible bonds (MSCB) with reset clauses to periodically reflect the market price of shares disadvantage existing shareholders.

In this context, the TSE is considering requiring disclosure of the legal opinion verifying the legality of issuance, reason for selection of the allotted party, holding policy of the allotted party and also requiring shareholder approval if a large amount of such securities is to be issued.

Samurai bonds

Foreign companies, especially US companies, have raised funds from the Japanese bond market through the issuance of 'Samurai' bonds: yen-denominated corporate bonds offered by foreign issuers in Japan. However, there have been no primary offerings of 'Samurai' bonds by US issuers since March 2006. This appears to be caused by US tax-related concerns arising from Japan's adoption of the new book-entry transfer system.

Japan is converting from the old recorded bond system to a truly paperless book-entry transfer system for bonds. The new book-entry transfer system operated by Japan Securities Depository Center (JASDEC) began operation as of January 10 2006 and is available to both domestic and foreign issuers.

While recorded bonds under the *Debentures and Bonds Registration Act* have been treated as bonds in bearer form for US tax purposes, book-entry bonds are feared to be in registered form for the same purpose because of their completely de-materialized nature. If they are in registered form, then under US law, issuers will be obliged to confirm non-US ownership of the bonds when making interest payments. Due to the unclear US tax consequences, US issuers have stopped issuing 'Samurai' bonds.

Nagashima Ohno & Tsunematsu

Kioicho Building, 3-12, Kioicho, Chiyoda-ku, Tokyo 102-0094, Japan

Tel: +81 3 3288 7000
Fax: +81 3 5213 7800

Website: http://www.noandt.com
Email: info@noandt.com